

STATE OF MINNESOTA  
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Application of  
Midwest Gas, a Division of Iowa  
Public Service Company, for Authority  
to Change Its Schedule of Gas Rates  
for Retail Customers Within the  
State of Minnesota.

FINDINGS OF FACT,  
CONCLUSIONS RECOMMENDATION  
AND ORDER

The above-entitled matter came on for public hearings before Allen E. Giles, Administrative Law Judge on February 6 and 7, 1991 in Cambridge and Coon Rapids, Minnesota, respectively. Evidentiary hearings were held on February 19, 21 and 25, 1991, in St. Paul. The record closed on April 23, 1991.

Parties to this proceeding include the following: Midwest Gas, a Division of Iowa Public Service Company (hereinafter also referred as "Midwest" or the "Company"); Minnesota Department of Public Service (herein also referred to as the "Department" or "DPS"); Office of Attorney General Hubert H. Humphrey, III (hereinafter also referred to as "Office of Attorney General" or "OAG"); and the Minnesota Senior Federation (hereinafter also referred to as "Senior Federation" or "MSF").

Appearances were made by the following: Steven R. Weiss, Senior Attorney, 401 Douglas Street, Box 778, Sioux City, IA 51102, for Midwest Gas; Scott Wilensky, Special Assistant Attorney General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101, for the Minnesota Department of Public Service; Julia E. Anderson, Special Assistant Attorney General, 340 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101, for Attorney General Hubert H. Humphrey, III; Elmer W. Scott, Iris Park Place, 1885 University Avenue, Suite 171, St. Paul, Minnesota 55104, appeared on behalf of the Minnesota Senior Federation.

Minnesota Public Utilities Commission Staff appearing at the hearing were David Jacobson, Robert Harding, Susan Holupchinski and Bret Eknes.

Notice is hereby given that, pursuant to Minn. Stat. 14.61, and the Rules of Practice of the Public Utilities Commission and the Office of Administrative Hearings, exceptions to this Report, if any, by any party

adversely affected must be filed within 20 days of the mailing date hereof  
with  
the Executive Secretary, Minnesota Public Utilities Commission, 160 East

Kellogg Boulevard, St. Paul, Minnesota 55101. Exceptions must be specific and stated and numbered separately. Proposed Findings of Fact, Conclusions and Order should be included, and copies thereof shall be served upon all parties.

If desired, a reply to exceptions may be filed and served within ten days after the service of the exceptions to which reply is made. Oral argument before a majority of the Commission will be permitted to all parties adversely affected by the Administrative Law Judge's recommendation who request such argument. Such request must accompany the filed exceptions or reply, and an original and 11 copies of each document should be filed with the Commission.

The Minnesota Public Utilities Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and had in the matter.

Further notice is hereby given that the Commission may, at its own discretion, accept or reject the Administrative Law Judge's recommendation and that said recommendation has no legal effect unless expressly adopted by the Commission as its final order.

#### STATEMENT OF ISSUES

Whether Midwest Gas should be permitted to increase its rates for retail sales of natural gas in Minnesota by \$2,590,902 in annual revenues, which it requested, or by some lesser amount, or not at all? If so, what should the amount be and how should it be apportioned among various classes of ratepayers?

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

#### FINDINGS OF FACT

##### INTRODUCTORY MATTERS

##### PROCEDURAL BACKGROUND

1. On September 14, 1990 Midwest Gas filed a Petition with the Minnesota Public Utilities Commission pursuant to Minn. Stat. 216B.16 (1990). The filing requested the Commission to increase Midwest Gas' rates for gas service within the State of Minnesota by \$2,590,902 or 5.7 percent.

2. On October 16, 1990, the Commission accepted the filing, ordered an investigation of the reasonableness of the proposed rates and suspended the proposed rates for ten months after filing or until the Commission reaches a determination, whichever occurs first.

3. On October 16, 1990, the Commission ordered a contested case hearing on the Petition. On November 15, 1990, a Prehearing Conference was held before Administrative Law Judge Allen E. Giles.

4. On November 9, 1990, the Commission authorized interim rates that would collect \$1,210,773 in additional annual revenues beginning on November 13, 1990. Interim rates are presently being collected, subject to refund of

any revenues collected in excess of the final rates determined by the Commission.

5. on November 26, the Administrative Law Judge issued a Prehearing Order establishing a schedule and setting various procedures for the proceeding.

6. Pursuant to the Prehearing Order and subsequent rulings of the Administrative Law Judge, the following Petitioners were allowed to intervene as parties to the proceeding: Minnesota Department of Public Service, Office of Attorney General and Minnesota Senior Federation.

#### PUBLIC HEARINGS

7. Public hearings were held on February 6 at 7:00 p.m. in Cambridge, Minnesota and on February 7 at 1:30 p.m. and 7:00 p.m. in Coon Rapids, Minnesota. No member of the public appeared at the Cambridge hearing. In Coon Rapids, three people appeared at the 1:30 p.m. hearing and four persons attended the 7:00 p.m. hearing. Commissioners Norma McKanna and Patrice Vick were present at the Cambridge public hearing. Commissioner Cynthia Kitlinski was present at the Coon Rapids hearings. Also in attendance at each of the public hearings were the parties.

8. Three persons testified at the public hearings: a small business rate payer and two senior citizens. Jim Cravers, owner of a local McDonald's Restaurant believed that the Company showed poor timing in making a request for a gas rate increase during a time in which there was also a business slowdown. He believed that a rate increase request at this time was inappropriate because of the recession. Two senior citizens, Walter Weslander and Joe Stitz, expressed the concern that senior citizens on fixed incomes would be especially hard hit by the increase. They stated that seniors will be required to stretch their pennies a little further and some seniors would be forced to turn off their heat. Mr. Stitz requested that a special rate be established for senior citizens on fixed incomes.

#### MIDWEST GAS

9. Midwest Gas is a retail distributor of natural gas and related transportation services operating in the States of Minnesota, Iowa, Nebraska, and South Dakota. The Company is an operating division of Iowa Public Service

(IPS), an electric and natural gas distribution utility. IPS separates its gas and electric operations into two divisions: the gas division - known as Midwest Gas; and the electric division - known as IPS Electric. Operating as Midwest Gas, IPS serves 347,000 customers in 208 communities located in western, central and north central Iowa, 38 suburban communities north of Minneapolis/St. Paul, Minnesota, eight southeast South Dakota communities and three northeast Nebraska communities. (Ex. 65, Midwest Energy Company, 1989 Annual Report).

10. IPS is a subsidiary of Midwest Energy Company (MWE). Midwest Energy Company has its principal offices located in Sioux City, Iowa. In January 1986, MWE acquired ownership of Donovan Companies, Inc., the parent corporation of North Central Public Service Company. Before the acquisition North Central

Public Service Company was a natural gas distribution company serving several northern tier Twin Cities metropolitan area communities. Midwest Gas succeeded

North Central Public Service as the gas distribution company serving these Minnesota communities. (Ex. 52, 3-4).

11. In November of 1990, Midwest Energy Company and Iowa Resources, Inc. merged to form a new company identified as Midwest Resources, Inc. (Vol. 4, Tr. p. 34).

12. In 1989 Midwest Gas served 38 Minnesota communities and 66,500 Minnesota customers with approximately 11.5 billion cubic feet of natural gas. These customers were served by approximately 1,350 miles of gas distribution main and 780 miles of service pipe. (Ex. 52, p. 3)

#### REVENUE REQUIREMENTS

13. A utility's revenue requirement is the level of revenues necessary for delivery of efficient and adequate service that at the same time maintains or preserves a utility's sources of capital. Whether a utility's revenues are adequate is determined by closely examining a utility's operating experience during a test period having representative levels of revenues, expenses, rate base and capital structure. As a utility seeking a rate change, Midwest has the burden of affirmatively establishing that its revenue collections during the test period are inadequate to maintain efficient delivery of service and inadequate to preserve Midwest's sources of capital. Minn. Stat. 216B.16, subd. 4 (1990).

14. The parties to this ratemaking proceeding are in agreement on most of the test year rate base, capital structure and operating income statement issues. The Findings and Conclusions herein primarily address issues that were contested by the parties.

#### TEST YEAR

15. Midwest has selected January 1, 1990 - December 31, 1990 as the test year to be used as a basis for determining its revenue requirements for providing retail gas distribution services within the State of Minnesota. The Company has used historical data for the first six month period ending June 30, 1990 and budgeted data for the remaining six months of 1990. There is no serious objection to the selection of a test year and Minn. Rules pt. 7825.3100, subp. 17 suggests that any 12-month period "selected by the utility" can be used. The Company's proposed test year period is found to be reasonable.

#### RATE BASE

16. The rate base is a measure of the capital of the utility which has been furnished by investors and is used to provide facilities for the delivery of service. Northwestern Bell Telephone Co, v. State, 253 N.W.2d 815, 818 (Minn. 1977). The Company is entitled to an opportunity to earn the prescribed rate of return on its entire rate base.



17. The Company initially proposed a 1990 test year net rate base of \$43,312,860. In its Supplemental Direct testimony the Company modified upward its proposed net rate base to \$43,662,376 to account for new depreciation rates, the elimination of a capital project and other minor adjustments.

18. Because of the agreements of the parties there is only one remaining rate base issue being contested, Midwest's request for an acquisition adjustment.

#### ACQUISITION ADJUSTMENT

19. Midwest has requested an acquisition adjustment to compensate its shareholders for the purchase of Donovan Companies, Inc., the parent company of North Central Public Services. The purchase price exceeded book value of the assets by approximately \$12 million. Approximately \$7 million has been allocated to the Minnesota jurisdiction. The acquisition adjustment is being amortized over 30 years at an annual expense of \$233,808. The total revenue impact of the acquisition adjustment claimed by Midwest is \$1,249,768, as demonstrated by Appendix A of Midwest's Initial Brief:

#### ACQUISITION ADJUSTMENT IMPACT:

PLANT IN SERVICE	\$7,014,091
RESERVE	(1,052,520)
NET PLANT	\$5,961,571
RATE OF RETURN	10.145%
RETURN	\$604,801
TAXES	411,159
REVENUE IMPACT	\$1,015,960
DEPRECIATION EXPENSE	
TOTAL REVENUE IMPACT	\$1,249,768

20. Based upon Midwest's analysis, the acquisition of North Central resulted in \$2,744,120 in savings as follows:

Savings Category	Amount
Capital Cost	\$1,515,000
A & G Expense	232,560
Materials and Supplies	27,560
Cost of Gas	969,000

21. Pursuant to Minn. Stat. 216B.16, subd. 6, a utility is eligible to

receive an acquisition adjustment if the acquisition is a "prudent acquisition". If there is a contest as to the reasonableness (amount) of an acquisition cost recovery, the utility must affirmatively demonstrate that the

acquisition itself has resulted in ratepayer benefits greater than the cost of the acquisition.

22. As a result of the acquisition of North Central Public Service Company, Midwest ratepayers will receive qualitative benefits in the areas of conservation, the environment, safety, internal systems and special programs for the public. Such qualitative benefits establish eligibility for acquisition cost recovery where there is no contest as to the amount of the recovery.

23. Midwest affirmatively demonstrated that ratepayers will receive quantitative savings benefits during the test year in the following areas: cost of capital savings; materials and supplies savings; and cost of gas savings

24. Midwest established test year cost of capital savings totaling \$1,091,199 as a result of the acquisition of North Central Public Service.

25. The Company demonstrated test year savings totaling \$27,557 for materials and supplies due to centralized Midwest Gas' purchasing as compared to the cost that would have been incurred by North Central.

26. Midwest established test year cost of gas savings totaling \$313,800 as a result of the acquisition of North Central Public Service.

27. Based on the Findings in paragraphs 23 through 26, Midwest will have test year acquisition related savings totaling \$1,432,556.

28. Acquisition-related savings of \$1,432,556 exceed acquisition costs of \$1,249,768. Because the acquisition-related savings result in net positive benefits to ratepayers, Midwest is entitled to recover its acquisition costs.

#### DISCUSSION

Minn. Stat. 216B.16, subd. 6 (1990) requires that the Commission consider for ratemaking purposes only those acquisitions that it deems are prudent acquisitions. In Inter-City Gas Corporation, Docket No. G-007/GR-83-317, April 10, 1984, the Commission made the following statement while disallowing a plant acquisition adjustment requested by Inter-City Gas:

The prudent- acquisition of assests is the minimum expenditure that a utility would incur in putting the public interest ahead of the interest\_of\_stockholders and management, for the purchase of an investment. Due to the poor financial conditions of the two acquired companies, the Commission finds that the payment of the excess purchase price for expansion of the Company's service area was for the benefit of the Company's stockholders and was not in the public interest. Consequently, the Commission finds that these acquisitions were not prudent. The Commission does not find it necessary to label this "good will" since the

facts show that the acquisition was for the benefit of the shareholders, as the examiner found.

The DPS urged the Commission to adopt the standard used by the Iowa State Commerce Commission, requiring the utility to present evidence which specifically relates the dollar amount of each benefit to the amount contained in the proposed adjustment. The Commission believes the Iowa standard was too restrictive. There may be occasions when a regulated company may pay an acquisition price in excess of book value. and show to the Commission's satisfaction that the excess price is prudent, in the public interest, and justified for ratemaking purposes without quantifying, a dollar for dollar benefit comparison. However, there must be showing that the cost is matched by benefits to ratepayers, and that has not been done here where the primary benefits went to the stockholders. Consequently, the commission will not adopt the standard proposed by the DPS.

(Emphasis added).

The DPS maintains that the Commission policy statement above allows a petitioning utility to obtain rate recovery of an acquisition adjustment without quantifying a dollar-for-dollar benefit comparison and establishes a "broad prudency standard" as to the appropriate value of an acquisition adjustment. The DPS further states that the instant request for recovery by Midwest demonstrates the need for a stricter policy. Similarly, Midwest maintains that the above policy language establishes that a showing of qualitative benefits to ratepersons may be all that is necessary to obtain recovery of an acquisition adjustment. The OAG asserts that this language requires that a petitioning utility that desires an acquisition adjustment must quantify the benefits being claimed to determine whether the benefits exceed costs.

The Administrative Law Judge believes that the above-quoted Commission policy statement taken as a whole requires that an acquisition adjustment be treated like any other component of rate base. Like any other component of rate base, an acquisition adjustment must be useful (provide benefits to ratepayers) in order to be considered. In addition, like any other component of rate base where the value is at issue, the Commission must determine the reasonableness of the value being claimed. The Administrative Law Judge agrees with the Office of Attorney General that quantification is critical to any meaningful analysis of cost and benefits. The Inter-City case cannot reasonably be read to lessen the obligation of a company to prove that benefits to ratepayers exceed the cost of acquisition. Without a quantitative measure of such costs and benefits, the Commission is without the necessary tools to evaluate whether or not a company has met its burden of proof. Thus, any analysis of a company's acquisition adjustment must be quantified in terms of dollars otherwise the Commission would have no basis for determining whether or not the utility in making the acquisition put "the public interest ahead of the interests of stockholders and management for purchase of an investment." The Commission has taken a recent opportunity to express its vigilance toward guarding the public interest with respect to acquisition adjustments in Proposed Merger\_of Minnegasco, Inc. With and\_into Arkla. Inc.,

Docket No. G-008/PA-90-604, November 28, 1990 where the Commission stated as

fol lows:

The commission finds that elimination of possible rate recovery for acquisition adjustment and good will is a safeguard for Minnegasco ratepayers and is consistent with the best interests of the public. Id. at 6.

Midwest asserts that it is entitled to the requested acquisition adjustment on the basis of both qualitative and quantitative benefits provided to ratepayers. The Administrative Law Judge notes that the qualitative benefits demonstrated by Midwest including for example "enhancements in the areas of conservation, the environment, safety, internal systems and new programs for customers" may establish eligibility for an acquisition adjustment but do not provide the Commission with meaningful measures to determine the extent of shareholder compensation for an acquisition. Insofar as a utility desires a compensation for the benefits, it has a responsibility or burden to come forward with a measurable basis for the acquisition. The failure to produce tangible, quantitative data upon which a reasonableness determination can be made results in a failure of proof or a failure of the utility to carry its burden of proving that an acquisition adjustment is just and reasonable as required by Minn. Stat. 216B.16, subd. 4 (1990).

With respect to quantifiable benefits, Midwest Gas asserts that the merger of North Central Public Service Company has resulted in measurable savings to customers in four categories: cost of capital savings; administrative and general savings; materials and supplies savings; and cost of gas savings. The measure of the quantitative savings were determined by comparing the relative cost for Midwest Gas in the 1990 test year against the cost that would have been part of the 1990 test year for North Central Public Service Company. Midwest claims that its acquisition adjustment is justified because it has shown cost savings of over \$3 million which exceed test year acquisition costs of \$1,296,135.

The Company claimed capital cost savings in the amount of \$1,828,991, this amount representing the difference in the cost for capital between North Central and Midwest Gas. The Department and OAG agreed that the cost of attracting capital was less for Midwest Gas as compared to North Central but that the difference was not at the level identified by the company. The Department asserted that the cost of capital savings total \$1,091,199 and the Attorney General believed that the savings were in the range between \$558,200 - \$801,618. The primary cause for the differences in the capital cost savings claimed by the parties is the value given to the equity component of North Central's capital structure.

The Company has proposed an equity ratio of 65.80% taken from the actual

capital structure of North Central at the time of the acquisition. The OAG disagrees sharply with Midwest's proposed equity ratio asserting that the Commission would likely have applied an equity ratio of 45% for ratemaking purposes and that an equity ratio as high as that proposed by the Company ought to lower the cost of attracting equity capital reflecting the lower risk associated with the high common equity. The Department asserts that the appropriate equity ratio is the one approved by the Commission in North Central's last rate case, 56.09%.

The Administrative Law Judge agrees with the Department and believes that



it is reasonable and appropriate to use the equity ratio approved by the Commission for ratemaking purposes in North Central's last rate case. Rates paid by ratepayers prior to the acquisition would have been based on the Commission approved 56.09% equity ratio. In determining the capital cost savings that result from the merger, it is appropriate to use this capital structure equity component. Use of the equity ratios proposed by the Company (65.80%) or by OAG (45%) are inappropriate because both of these equity ratios are based on speculation regarding what the Commission would do if North Central had filed a rate case in 1990. Instead of engaging in this speculation, it is appropriate to use an equity ratio already approved for ratemaking purposes for North Central. The Administrative Law Judge adopts the DPS' determination of capital cost savings.

The Company claimed \$232,560 as administrative and general expense savings due to the merger of North Central and Midwest Gas. After review of the quantitative analysis giving rise to this savings claim for administrative and general expenses, the Administrative Law Judge believes that the Company has failed to prove by a preponderance of evidence that \$232,560 in administrative and general expense savings resulted from the acquisition. Both the Department and OAG sharply disagreed with the methodology and quantitative results giving rise to this figure. The Department and the Attorney General proposed alternative measures or means for computation of administrative and general expenses that showed that potential savings were far less than that being claimed by the Company. The Company's response to these objections has been unpersuasive.

The Company next asserts that Midwest Gas customers will realize annual gas cost savings of \$969,000 as a result of the acquisition of North Central. The savings are related Midwest's ability to make zone transfers and creates pipeline competition by interconnecting with Natural Gas Pipeline Company. Both the OAG and DPS agreed that ratepayers will realize gas cost savings but asserted that the Company's claims were substantially overstated. OAG and DPS asserted that many of the Company's gas cost savings were speculative and unsupported by the record. Nevertheless, both concluded that there were substantial gas cost ratepayer savings. The OAG calculated the gas cost savings as being \$313,800 and the DPS determined that the savings totaled \$584,000. The Administrative Law Judge concurs with the assessment that many of the Company's gas cost claims are speculative and unsupported by the record. The Administrative Law Judge specifically concurs with the comprehensive assessment of gas cost savings done by the Attorney General and has adopted the \$313,800 calculated for these savings.

#### RATE BASE SUMMARY

29. Based upon the previous Findings of Fact relative to the rate base and based upon the record regarding the remaining components, the appropriate average test year jurisdictional rate base for use in this proceeding is \$42,794,577 calculated as follows:



MIDWEST GAS  
RATE BASE - MINNESOTA JURISDICTION  
TEST YEAR ENDING DECEMBER 31, 1990  
(From Exhibit 61)

PLANT INVESTMENT

Production & Storage	\$ 2,113,182
Distribution	51,870,982
General & Intangible	4,640,307
Common (Gas)	724,115
Acquisition Adjustment	7,014,091
Total Plant Investment	\$66,362,677

RESERVE FOR DEPRECIATION

Production & Storage	\$ 1,040,926
Distribution	15,307,609
General & Intangible	1,760,557
Common (Gas)	182,830
Acquisition Adjustment	1,052,520
Total Reserve for Depreciation	\$19,344,442

NET PLANT IN SERVICE \$47,018,235

LESS:

Accumulated Deferred Income Taxes	\$3,538,839
Customer Advances	107,432
Customer Deposits	23,417
Accrued Provision - Uncollectible	256,178
Accrued Provision - Inj. & Damage	51,450
Misc. Operation Provisions	26,907

ADD: WORKING CAPITAL

Fuel Stocks	\$ 1,061,112
Materials & Supplies	719,707
Prepayments	73,584
Time Lag	(399,909)
Advance Tax Collections	(1,383,164)
Interest on Long-Term Debt	(281,576)
Preferred Stock Dividends	(9,189)

TOTAL GAS RATE BASE \$42,794,577

## TEST YEAR OPERATING INCOME

### Forecast of Gas Sales and Revenues

30. Midwest's test year operating income statement consists of six months actual and six months projected data. Accordingly, its sales revenues are based in part on forecasted and in part on actual data.

31. Midwest and the Department used mathematical formulas and statistical techniques to estimate revenues from projected sales during the test year. The purpose of these mathematical and statistical models was to forecast the number of customers and their weather-normalized usage by month and by customer class during the test year.

32. In its initial filing Midwest projected weather-normalized revenues of \$45,552,513. This figure was increased to \$45,658,925 based upon an updated customer count contained in the Company's Supplemental Direct Filing.

33. The Department's analysis of projected gas sales and revenues utilized Midwest's updated customer counts but applied statistical techniques and methodologies that, for the purposes of this proceeding, more accurately determine weather-normalized usage of customers by month and by customer class.

34. The Department forecasted gas sales of \$46,189,952 and gas costs amounting to \$32,242,593.

35. Midwest has agreed that the Department's test year forecast of cost of gas and gas sales and revenues should be used for ratemaking purposes in this proceeding.

36. The Department's forecast of test year sales and revenues are reasonable and should be used in developing the appropriate operating income statement for ratemaking purposes.

## UNBILLED REVENUES

37. Unbilled revenues constitute the difference between the natural gas usage billed each month and the amount actually used by a customer. If all customers meters were read and billed on the last day of the month, there would be no unbilled revenues. As a practical matter it would be impracticable to read all customers meters on the last day of the month. Thus, the natural gas used by a customer after a monthly meter reading is unbilled until the meter is read for the subsequent month. The occurrence of such unbilled revenues presents a ratemaking issue because the cost of delivering the natural gas to the customer will be reflected in the month the service is provided resulting in a mismatch of natural gas used versus natural gas billed for the particular month. The inclusion of such costs of service without matching revenues may result in an overstatement of the revenue deficiency.

38. Midwest Gas has properly included test year unbilled revenues as a



part of the overall test year revenues. In doing so the Company achieves a proper matching of test year revenues and test year expenses.

39. Midwest Gas has properly reflected the 1990 test year level of unbilled revenues and has properly excluded prior to test year accumulated unbilled revenues consistent with previous Commission decisions.

#### DISCUSSION

The OAG has proposed adjustments requiring all unbilled revenues (arising in or outside of the test year) to be recognized for ratemaking purposes. The OAG's first adjustment related to customer natural gas usage that was unbilled during the last two weeks of the 1990 test year (i.e., after approximately December 15, 1990). After reexamination of Midwest's computation of test year unbilled revenues, the OAG has conceded that Midwest's calculation of 1990 test year unbilled revenues does not result in a mismatching of test year costs and revenues.

The OAG's second proposed adjustment regarding unbilled revenues related to accumulated unbilled revenues that were on the books of Midwest prior to the beginning of the 1990 test year. Midwest's accumulated unbilled revenues as of December 31, 1989 amounted to \$2,851,686. The OAG asserted that because these accumulated unbilled revenues had not been previously reflected in rates paid by customers of Midwest Gas or its predecessor, North Central, customers have been previously overcharged. In support of its position the OAG notes that Midwest Gas recognizes accumulated unbilled revenues in test year revenues in its revenue requirement for natural gas service delivered in the State of Iowa; Midwest has recognized unbilled revenues for financial reporting purposes resulting in increased net operating income and a higher return for investors; and that other state utility regulators have required that unbilled revenues be recognized for ratemaking purposes (i.e., Florida, Vermont and Wisconsin). Finally, the OAG argues that unbilled revenues should be recognized - to avoid overcharging ratepayers and to credit ratepayers for previously paying too much. If shareholders are to be reimbursed for costs of the past acquisition, then Minnesota ratepayers should be reimbursed for the amount of the past overcharge.

The Commission has previously rejected the adjustment proposed in this case by OAG in numerous other cases. Northern States Power Company, E-002/GR-85-558 (June 2, 1986) at 35 "Order After Rehearing and Reconsideration" (August 6, 1986); Northern State, Power Company, G-002/GR-86-160 (January 27, 1987) at 23-24; and Ottertail Power Company,

E-017/GR-86-380 (April 27, 1987) at 20-22. Those decisions were based on compelling factors that also apply in this proceeding.

In view of this previous Commission policy as identified in the cases which address this issue, the OAG has offered no reason why the Commission should modify that policy. In addition, no effort has been made to distinguish the circumstances of this case from other cases. The OAG does rhetorically offer that if it is fair to provide investors the benefit of an acquisition adjustment in this case, then it is also fair to provide ratepayers the benefit of the unbilled revenues. However, if investors get the benefit of an acquisition adjustment, they will not get it because it is fair. Investors must affirmatively demonstrate test year benefits of the

acquisition to be entitled to receive an adjustment. Finally, the OAG's reliance on the Iowa case is misplaced. That case involved a non-litigated settlement. In addition, unlike the instant situation, the Iowa case involved unbilled revenues that arose during the test year.

In summary, the Company has demonstrated that its treatment of unbilled revenues is reasonable and appropriate.

#### MARKETING-EXPENSES

40. Midwest proposes to recover the cost of three marketing programs. Those programs are the Electric Water Heater Conversion Program, the Dealer Appliance Program, and the Conversion Rebate Program. The Company provided no analysis of the cost-effectiveness of these programs in its direct testimony. The Department evaluated each of these programs applying a "No Losers Test" to ascertain whether or not the marketing programs generated sufficient revenues to justify their cost.

41. The Electric Water Heater Conversion Program offers homeowners an opportunity to replace electric hot water heaters with natural gas water heaters by paying \$49.95 for the water heater plus installation cost. The net present value of the program's benefits over a five-year period is \$123.23 per customer or an annual average of nearly \$25 for each customer that participates. Therefore, the program will generate sufficient revenues to justify its costs. The Company initially sought to recover \$10,783 for the expenses of marketing the Electric Water Heater Conversion Program. However, in its rebuttal testimony, Midwest increased the expenses associated with the project to \$14,130 without providing an explanation or otherwise justifying the increase in cost.

42. It is reasonable to include in expenses, \$10,783 as recovery of costs for marketing the Electric Water Heater Conversion Program. The additional amount of \$3,347 has not not been justified and therefore should be excluded from expenses.

43. Midwest seeks to recover \$2,500 in expenses associated with marketing the Dealer Appliance Program. The purpose of this Program is to provide an incentive program to encourage the sale of gas appliances by dealers and their sales personnel. The Department's analysis demonstrates an annual net present value of \$25 per customer. Therefore, this program generates sufficient revenues to justify costs and the \$2,500 expense should be recovered in rates.



44. Midwest sought to recover \$45,000 of expenses it incurred marketing the Conversion Rebate Program. The purpose of this program is to help existing homeowners offset the cost of converting appliances such as dryers, ranges and furnaces to gas. The Company provides rebates of up to \$150 per customer. As with the expenses of the other marketing programs, the Company failed to include in direct testimony affirmative support for the expenses of the Conversion Rebate Program. The Department's evaluation of the program demonstrated that the program was not cost effective for ratepayers. Therefore, it is reasonable to exclude this amount from the expenses claimed for ratemaking purposes.

#### SALES EXPENSES

45. Midwest included certain sales expenses totalling \$90,366 that were not justified or otherwise explained in the Company's direct testimony. The unaccounted for expenses by account number are as follows: Account 911 - \$23,858; Account 912 (less marketing expenses) - \$62,428; and Account 916 - \$4,080. In its rebuttal testimony the Company removed \$31,190 of these sales expenses. The Company provided a reasonable explanation and support for labor expenses in Accounts 911 and 912 and business forms in Account 912. It failed to provide any evidence in support for Account 916 and in its rebuttal testimony removed the \$4,080 included in Account 916 from its list of sales expenses. The Company failed to provide any information on the \$5,000 economic development grant to the Coon Rapids Economic Development Corporation or the \$1,566 gas cooking incentive line item.

46. The Department has proposed to adjust sales and marketing expenses by \$90,183 based on the Company's withdrawal of items from consideration or the Company's failure to affirmatively justify the expenses. Midwest has agreed to these marketing-related adjustments proposed by the Department.

47. It is reasonable and appropriate to reduce the expenses eligible for rate recovery by \$90,183 as proposed by the Department.

#### DISCUSSION

The Department has also requested that the Commission require Midwest to file direct testimony and supporting analysis regarding marketing expenses in its next rate case. The Department noted that the failure of the Company to include justification for the various expenses delayed its consideration of these items. Direct testimony would have expedited the Department's analysis of these programs. The Administrative Law Judge is reluctant to support a requirement that Midwest make these filings in future rate cases. Midwest, like other utilities, already has a substantive burden to justify each and every component of its rate change application including its expenses. When a utility fails to include in its direct testimony an explanation and justification for rate relief, the utility simply has failed to meet its burden of proof. With respect to the expenses discussed here, it is the Department's cost effectiveness analysis of the various programs that saves the expenses from being disallowed altogether. The Department is not required to solicit justifications from a utility to ascertain the reasonableness of expenses claimed by the utility. A utility should not be allowed to use its rebuttal testimony as the primary justification for a claimed expense. The Company waived an opportunity to provide affirmative justification for program expenses when it did not include justification for the expenses in its direct testimony. It runs the risk of a similar disallowance in the future if it fails to provide adequate justification.

#### CONSERVATION EXPENSES

48. Midwest's initial filing did not include any proposal for recovering conservation improvement program expenses. A conservation improvement program

(CIP) budget was approved by the Commissioner of the Department of Public Service during the test year in sufficient time for the Company to include a request for recovery of these expenses in its Supplemental Direct Testimony. The conservation improvement program budget approved by the Commissioner of

the Department of Public Service in the amount of \$148,560 is a known and measurable change that should be included in test year expenses. A conservation cost recovery charge should be built into rates to allow the Company to collect the \$148,560 expenses associated with the approved conservation improvement plan.

49. Midwest seeks recovery of expenses of \$2,000 associated with the Company's Energy Conservation Library, a program that provides informational brochures upon request. Midwest offers about 35 different brochures and has about 50 copies of each which at the \$2,000 expense level amounts to approximately \$1.14 per brochure. Some of the brochures can be obtained from the Department at no cost, others of the brochures contain information regarding electricity. The Company has failed to provide an affirmative justification for this expense and has not rebutted the Department's recommendation that the expense be disallowed. It is reasonable to exclude the expense of this item from recovery.

50. Midwest initially included as a part of its test year cost lobbying expenses of \$14,000 and Chamber of Commerce dues of \$1,530. Midwest has withdrawn its request to recover these expenses in the instant ratemaking proceeding. The effect of withdrawal of lobbying and Chamber of Commerce expenses has not been included in the test year operating income.

#### TEST YEAR OPERATING INCOME SUMMARY

51. Based upon the previous Findings of Fact regarding the Company's operating income and expenses, including agreements of the parties, the appropriate net operating income 1/ for the test year is \$3,155,014 calculated as follows:

#### MIDWEST GAS OPERATING INCOME SUMMARY FOR TEST YEAR ENDING DECEMBER, 31, 1990 (From Exhibit 61)

OPERATING	REVENUES	\$46,189,952
OPERATING	EXPENSES	
	Gas Purchases	\$32,242,593
	Production Expense	5,781
	Distribution Expense	1,129,734
	Maintenance Expense	800,333
	Customer Acct. Expense	1,780,588
	Sales Expense	58,466
	Gen. & Admin. Expense	2,261,184
	Depreciation Expense	2,324,945
	Other Taxes	1,708,118
	Income Taxes	23,196

TOTAL OPERATING EXPENSES	\$43,034,938
NET OPERATING INCOME	\$ 3,155,014

I/ This computation does not contain the effect of Midwest's withdrawal of Lobbying and Chamber of Commerce expenses. It also does not contain the effect of the computation of revenues from flexible rates using the "standard

## CAPITAL STRUCTURE

52. Capital structure is a financial concept which represents the sources of capital to a company. The major sources of capital are debt and equity. Conceptually, the inquiry is to determine what balance of these capital sources is appropriate for ratemaking purposes as being in the best interests of both the company and its ratepayers. United Telephone Company, P-430/GR-83-599, Order After Reconsideration, September 6, 1984; Northern States Power Company, Docket No. E-002/GR-87-670, August 23, 1988, pp. 38-39.

53. The appropriate mixture of capital is a function of the interaction between the perceived business and financial risk of the company. In general, the greater the business risk, the higher the proportion of common equity that is appropriate in the capital structure. Interstate Power Company, Docket No. E-001/GR-86-384, May 1, 1987, p. 29.

54. Midwest is a division of Iowa Public Service. It does not seek out financing in capital markets. Financing for the Midwest operations are accomplished through Iowa Public Service. IPS is a subsidiary of Midwest Resources, Inc. which was created in November 1990 as a result of the merger of Midwest Energy, Inc. and Iowa Resources, Inc. It is appropriate to select a substitute capital structure from either IPS or Midwest Resources, Inc.

55. Because Midwest is a division of IPS and IPS is a regulated utility, using the capital structure of IPS as a proxy, instead of Midwest Resources, Inc., more closely reflects the actual financing of the operations of Midwest.

56. Midwest's initial capital structure filing included a component for short-term debt. In rebuttal testimony Midwest withdrew the short-term debt component and updated the capital structure using eleven months of actual data.

57. The capital structure proposed by the Company in its rebuttal testimony was not opposed by any party. The following arrangement of capital sources is the appropriate capital structure for this proceeding:

### MIDWEST GAS CAPITAL STRUCTURE

Component	Amount	Ratio
Long Term Debt	\$308,816,240	46.51%
Preferred Stock	\$ 64,719,198	9.75%
Common Equity	\$290,480,310	43.74%
	\$664,015,748	100.00%

### COST OF LONG TERM DEBT AND PREFERRED STOCK

58. The actual cost of long term debt is 8.592%. The cost of preferred



stock is 6.983%. No party disputes that these are the appropriate costs for long term debt and preferred stock.

#### COST OF COMMON EQUITY

59. The cost of common equity is the return on an investment that an investor requires in order to induce the purchase of an equity investment in a particular corporation.

60. The market price of a share of common stock depends on three factors: (1) the dividend per share; (2) the anticipated rate of future dividends granted; and (3) the investor's required rate of return on investment.

61. All of the rate of return witnesses in this case employed some form of Discounted Cash Flow ("DCF") analysis to derive their cost of equity recommendations. The DCF method is used to estimate the cost of a utility's common equity. The method is intended to estimate what shareholders require as a rate of return, not what return a company will probably or actually earn.

62. The DCF method is the appropriate method for estimating the cost of equity in this ratemaking proceeding. This method is a market-oriented opportunity cost approach which views the relationship between the cost of equity, the investor's income expectations and market price in a theoretically sound and organized manner. It infers the rate of return which investors implicitly require of a particular equity investment.

63. The DCF method is widely accepted in modern financial literature as an appropriate method for determining a utility's required return on equity. It has been accepted by the Minnesota Public Utilities Commission as the most reliable method of calculating return on equity. Northern State, Power Company, Docket Nos. G-002/GR-86-160; G-002/M-86-165 (1987); Continental Telephone Company, Docket No. P-407/GR-83-294.

64. Four expert witnesses testified to a specific rate of return on common equity to be applied to Midwest Gas. Three of the witnesses, including the Company's witness, Mr. Paul R. Moul, have concluded that a reasonable estimate of the cost of equity to Midwest Gas for ratemaking purposes is 12.5 percent. The Department's witness, Dr. Eilon Amit, and OAG expert witness, Dr. Richard M. McIntire, while working independently of each other, have estimated that the cost of equity to Midwest Gas is 12.5 percent. Minnesota Senior Federation witness, Dr. Kenneth M. Zapp, recommended a rate of return of 12.2 percent.



65. The theoretical foundation of the DCF method is that investors make their investment decisions based upon an evaluation of dividends and growth in dividends from future earnings. An investor's (expected) required rate of return is the sum of these two factors, dividends and growth in dividends from future earnings. To determine a DCF estimation of investors required rate of return these two factors, dividends and growth in dividends, must be determined.

66. Investors cannot purchase shares in Midwest because it is a division

We have previously noted that the fixing of a fair rate of return cannot be determined with precision since it is not derived from a formula, but must be reached through the exercise of a reasonable judgment.

The witnesses testifying with respect to rate of return have also recognized that the determination is one calling for the exercise of reasonable judgment rather than the mechanical application of formulas.

The legal standards governing the exercise of such reasonable judgment have been the subject of two decisions by the United States Supreme Court. *Federal v. Hope Natural Gas Company*, 320 U.S. 591 (1944); *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923). The standards enunciated by the United States Supreme Court in both *Hope Natural Gas Company*, *supra*, and *Bluefield*, *supra*, have been adopted by the Minnesota courts. See, e.g., *Hibbing Taconite Company v. Minnesota Public Service Commission*, 302 N.W.2d 5, 10 (Minn. 1980). The general principles governing the determination of a reasonable rate of return on equity for a public utility as derived from *Hope*, *supra*, and *Bluefield*, *supra*, include the concepts that the allowed rate of return must be comparable to that earned on investments and business undertakings which are unregulated but are attended by similar risks; the return must be sufficient to enable the utility to maintain its financial integrity; and the return should be sufficient to attract new capital on reasonable terms.

The Commission in determining a fair rate of return on equity, may balance consumer and investor interests. *Permian Basin Area Rate Cases*, 390 U.S. 747, 791 (1968). The Commission may not, however, consistent with due process allow less than a reasonable rate of return on common equity in order to accommodate consumer interests. *Bluefield Water-Works and-improement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 690 (1923); *Hibbing Taconite Company v. Public Service Commission*, 302 N.W.2d 5 (Minn. 1980). Moreover, finding a fair rate of return on common equity is a judicial, rather than a quasi-legislative determination. *Minnesota Power and Light Company v. Public Service Commission*, 310 N.W.2d 686 (Minn. 1981).

The record contains substantial evidence in support of 12.5% as the appropriate estimate of the cost of equity for ratemaking purposes. Both the DPS witness Dr. Amit and OAG witness Dr. McIntire arrived at this conclusion independent of each other, using different values and inputs for their DCF components. On the basis of this record, the Administrative Law Judge believes that the Commission could rely on either Dr. Amit or Dr. McIntire for support of 12.5% as the cost of equity in this proceeding.

As can be noted from the Findings above, the Administrative Law Judge has adopted the analysis of Dr. McIntire. The Administrative Law Judge selected Dr. McIntire's testimony over Dr. Amit's for the following reasons. The first reason relates to the length of the period selected by Dr. Amit for calculating the dividend yield. Dr. Amit indicated that historical dividend yields are not useful indicators of future dividend yields and that the most recent dividend yield incorporates all relevant information. Therefore, according to Dr. Amit, a 4-week analysis of closing prices was adequate for computing the dividend yield. It is unclear if the Commission has previously

relied on or adopted a dividend yield calculated based upon only four weeks of closing prices. In fact, it appears that the Commission has relied on a 12-month period for this purpose. See, e.g., Central Telephone Company, Docket No. P-405/GR-83-300, March 30, 1984 at 32; United Telephone Company, Docket No. P-430/GR-83-599, June 28, 1984 at 14; and Peoples Natural Gas Company, Docket No. G-011/GR-83-188, February 8, 1984 at 29-30.

Another reason the Administrative Law Judge has not adopted Dr. Amit's testimony is his inclusion of a flotation cost adjustment for issuance of stock. Dr. Amit's rationale for inclusion of a flotation cost adjustment is reasonable and on a sound basis. In this case, however, Midwest has failed to affirmatively establish facts that support a flotation cost adjustment. Thus, although the Administrative Law Judge recognizes that there may be circumstances where a flotation cost adjustment is appropriate according to Dr. Amit's reasoning, the specific circumstances of this case do not warrant such an application.

Midwest has taken the position that the recommendations of the OAG and DPS of 12.5% be adopted as the cost of equity for this ratemaking proceeding. The Company has, however, continued to challenge the application of the DCF method by these parties. For example, the Company asserts that the DCF method should not be blindly followed and that the DCF estimate is a judgment call like other methods of estimating cost of capital. The testimony of OAG's Dr. McIntire and DPS' Dr. Amit are the only evidence in the record supporting 12.5% as the appropriate cost of equity for this proceeding. Accordingly, the Company has mellowed its objections to the DCF applications of these two witnesses.

The Minnesota Senior Federation through its expert witness, Dr. Kenneth F. Zapp, opposed the recommendation of 12.5% as the cost of equity in this proceeding. Dr. Zapp had only one criticism of Dr. McIntire's application of the DCF analysis. He believed Dr. McIntire's computation of 5.2% as the growth rate of dividends per share was flawed and inconsistent. In arriving at his determination of 5.2% as the growth rate, Dr. McIntire placed more emphasis on investor expectations for future growth. He used the Value Line projections of the growth statistics on page 1 of Schedule 3 of Exhibit 41 which showed an average of 5% growth rate for the comparable gas distribution companies. However, because historical growth rates of dividends per share were generally consistently above 5% for five and 10-year historical periods, he adjusted his growth rate recommendation up to 5.2% to take into consideration that historical pattern as seen on page 2 of Schedule 3, Exhibit

41. The Administrative Law Judge does not consider this analysis as being inconsistent or otherwise unreasonable.

The Minnesota Senior Federation recommended that 12.02% be adopted as the cost of common equity in this proceeding. The Administrative Law Judge has considered the Minnesota Senior Federation's recommendation including Dr. Zapp's DCF analysis but is unpersuaded. The Administrative Law Judge has selected the analysis of Dr. McIntire as representing a consistent application of a recognized method using objective, representative data in accordance with the past practices of the Commission. The recommendation of 12.5% as the cost of equity correctly balances consumer and investor interests in this proceeding.

74. The overall rate of return is calculated by multiplying the capitalization ratios by their appropriate costs. The sum of these weighted costs is the overall rate of return on capital. The overall rate of return in this proceeding is found to be 10.144%, based on the following calculation:

MIDWEST GAS OVERALL RATE OF RETURN			
Cost	Component	Percent of \$ Amount	Cost Rate (%)
	Long Term Debt	46.51%	8.592%
	Preferred Stock	9.75%	6.984%
	Common Equity	43.74%	12.50 %
	Total		10.144%

75. As a consequence of the Findings of Fact regarding rate base, test year operating income and cost of capital, the revenue deficiency of Midwest is \$1,992,386, as hereinafter calculated:

MIDWEST GAS  
SUMMARY OF REVENUE DEFICIENCY  
(From Exhibit 61)

TEST YEAR ENDING DECEMBER 31, 1990

Average Rate Base	\$42,794,577
Rate of Return	0.10144
Required Operating Income	4,341,082
Test Year Operating Income	3,155,014
Income Deficiency	1,186,068
GROSS Revenue Conversion Factor	1.679825
GROSS Revenue Deficiency	1,992,386

RATE DESIGN

76. Midwest bears the burden of proof that the proposed rate design is just, reasonable and not unreasonable, preferential or discriminatory. Minn. Stat. 216B.03 and 216B.16, subd. 4 (1990).

77. When the Commission allocates the revenue deficiency among classes of customers to provide for the recovery of a revenue requirement, it acts in a quasi-legislative capacity and may fix rates based on cost and non-cost

factors. Hibbing Taconite Company v. Minnesota Public Service Commission, 302

N.W.2d 5, 9 (Minn. 1980); St. Paul Area Chamber of Commerce v. Minnesota Public Service Commission, 312 Minn. 250, 262, 251 N.W.2d 350, 358 (1977).

78. Having established a revenue deficiency, if Midwest does not establish the reasonableness of its proposed rate design, then the Commission must determine just and reasonable rates to allow for the recovery for the

revenue deficiency. Minn. Stat. 216B.16, subd. 5 (1990).

79. As with other aspects of this ratemaking proceeding, the parties are in basic agreement regarding rate design matters except as discussed herein.

#### CONSOLIDATION OF THE VIKING AND NORTHERN NATURAL SYSTEMS

80. Midwest proposes to consolidate into one tariff customers served by the Viking Gas Pipeline and by the Northern Natural Gas Pipeline. The Viking system serves approximately 1,000 customers and the Northern system serves approximately 70,000 customers in Minnesota. The Company views the two systems as being integrated within Midwest's service territory. The reason for combining the tariffs offered by the Company is the elimination of the duplicative administrative procedures required to administer the separate tariffs. Viking customers would experience significant increases upon merger of the tariffs.

81. The Department examined the cost of customers serving on the Viking and Northern Natural Gas systems to determine if the cost varied. The analysis showed significant differences in the cost of gas and the non-gas costs imposed by customers on the two systems. Gas purchased for customers on the Northern system is used only on the Northern system and gas purchased for customers on the Viking system is used only on the Viking system. Thus, there are identifiable distinct differences in gas costs for the two systems. There are also distinct differences in non-gas costs due to the age of the two systems and the relative growth on each system. The Department determined customer cost responsibility based on the same method used by the Commission when it set rates in North Central's last rate case. The Department's method of analysis and determination of customer cost responsibility for customers on the Viking and Northern Natural systems is reasonable and appropriate.

82. At the present time the Viking and Northern Natural systems are not physically integrated. There is no interconnection that allows for transfer of gas from one system to the other. Midwest has no timetable for interconnecting and fully physically integrating these systems into one. The cost differences between the two systems will continue for the foreseeable future.

83. Midwest has failed to meet its burden of proving that consolidation of the Viking and Northern Natural Gas systems will achieve customer savings and result in fair and equitable treatment for Minnesota customers. A principle of rate design is that rates should be designed to provide an efficient use of natural resources. Efficient use of resources requires that the revenue responsibility assigned each class should reflect the cost of serving that class. It is reasonable and appropriate that the Viking and Northern Natural systems continue to operate as separate systems. The Administrative Law Judge is unpersuaded that the administrative savings and convenience achieved by the consolidation of the two systems is offset by the rate shock that would be experienced by the Viking customers. The Administrative Law Judge surmises that there would be administrative savings by the consolidation of the tariffs but notes that the Company has made no effort to quantify those savings.



84. In the event that the Commission allows consolidation, it should

74. The overall rate of return is calculated by multiplying the capitalization ratios by their appropriate costs. The sum of these weighted costs is the overall rate of return on capital. The overall rate of return in this proceeding is found to be 10.144%, based on the following calculation:

MIDWEST GAS OVERALL RATE OF RETURN			
Cost	Component	Percent of \$ Amount	Cost Rate (%)
	Long Term Debt	46.51%	8.592%
	Preferred Stock	9.75%	6.984%
	Common Equity	43.74%	12.50 %
	Total		10.144%

75. As a consequence of the Findings of Fact regarding rate base, test year operating income and cost of capital, the revenue deficiency of Midwest is \$1,992,386, as hereinafter calculated:

MIDWEST GAS  
SUMMARY OF REVENUE DEFICIENCY  
(From Exhibit 61)

TEST YEAR ENDING DECEMBER 31, 1999

Average Rate Base	\$42,794,577
Rate of Return	0.10144
Required Operating Income	4,341,082
Test Year Operating Income	3,155,014
Income Deficiency	1,186,068
GROSS Revenue Conversion Factor	1.679825
GROSS Revenue Deficiency	1,992,386

RATE DESIGN

76. Midwest bears the burden of proof that the proposed rate design is just, reasonable and not unreasonable, preferential or discriminatory. Minn. Stat. 216B.03 and 216B.16, subd. 4 (1990).

77. When the Commission allocates the revenue deficiency among classes of customers to provide for the recovery of a revenue requirement, it acts in a quasi-legislative capacity and may fix rates based on cost and non-cost

factors. Hibbing Taconite Company v. Minnesota Public Service Commission, 302

N.W.2d 5, 9 (Minn. 1980); St. Paul Area Chamber of Commerce v. Minnesota Public Service Commission, 312 Minn. 250, 262, 251 N.W.2d 350, 358 (1977).

78. Having established a revenue deficiency, if Midwest does not establish the reasonableness of its proposed rate design, then the Commission must determine just and reasonable rates to allow for the recovery for the

require a roll-in over two rate cases to alleviate rate shock for Viking customers.

#### REVENUE APPORTIONMENT

85. The DPS and the Company have taken the position that the margins (commodity rates minus gas rates) on the rates for all classes remain at current levels, except for the Small Firm classes. DPS and the Company believe that the margins for the Small Firm classes should be increased sufficiently to allow total revenues from all classes to cover the Company's revenue requirement.

86. The Attorney General recommends all classes receive a 1% increase on their average bills. Minnesota Senior Federation supports the Attorney General's recommendation.

87. Both of these proposals will have the effect of moving Small Firm customer rates closer to cost. The primary difference between the two proposals is that the Company's proposal will move Small Firm customers rates toward cost at a faster pace. The Company's proposal would result in a percentage increase in Small Firm customers' bills of 6.2% and a non-gas cost increase of 20.7%. In contrast, Medium Firm customers' bills would increase only .2% and reflect a non-gas cost increase of .8%. Thus, under the Company's proposal almost all of the proposed increase will fall upon the Small Firm (residential) customers. Residential customers generally do not have alternative fuel choices, therefore it is unlikely that the Small Firm customers will have any choice but to pay the increased costs. A principal concern discussed by ratepayers during the public hearings was the impact of increased rates on low, fixed income households.

88. While cost is an important factor to be considered in determining the allocation of rates among customers, it is also important to consider non-cost factors in a proper balancing of public policy and private need. Reserve Mining Company v. Public Utilities Commission, 334 N.W.2d 389, 393 (Minn. 1983); St. Paul Area Chamber of Commerce v. Minnesota Public Service Commission, 312 Minn. 250, 261, 251 N.W.2d 350, 358 (1977). In addition, rates should provide reasonable continuity with past and future rates to prevent immediate or inordinate impact on existing and future customers. Taking these ratemaking principles into consideration, the Administrative Law Judge believes that it is appropriate to cushion the impact of this rate increase on Small Firm (residential) customers in the manner proposed by the Attorney General and the Minnesota Senior Federation. A 1% increase for all customer classes is appropriate in this case. Such an increase considers historical rate continuity and at the same time moves Small Firm customers toward costs.

#### RECONNECTION CHARGES

89. Midwest proposed reconnection charges of \$20 during normal working hours and \$30 for all after-hours reconnections. The Department initially recommended setting both regular and after-hours reconnection fees at \$20. Midwest and the Department have agreed that the appropriate cost for reconnection charges should be \$21 during normal working hours and \$23 for



after-hours reconnections.

90. The Administrative Law Judge finds that reconnection charges agreed to by Midwest and the Department are more closely in line with the costs than the charges initially proposed by the Company. It is therefore appropriate and reasonable to set reconnection charges at \$21 during normal business hours and \$23 for after-hour connections.

#### NEW MEDIUM FIRM CLASS

91. Midwest proposed a new Medium Firm ("MIO") class, available to customers having peak-day requirements of 500 therms or more. The margin per therm would be lower for the Medium Firm customers than for Small Firm customers. The DPS and the OAG do not oppose the creation of this new class. The creation of the new class is reasonable since the monthly consumption for the class is well above the usage of other typical Small Firm customers. These customers also have a higher load factor; therefore their per-unit costs are lower.

92. Because the Medium Firm class will be a new class, the Company should conduct a load study of customers in the class to verify their actual load factors. In addition, the Company should further evaluate the reasonableness of the 500-therm limit. This information should be provided in the Company's next general rate case.

93. It is appropriate and reasonable that a Medium Firm class be created and that a study of usage patterns be undertaken by the Company and reported in the next general rate case filing.

#### SPECIAL PROVISION TO ATTRACT NEW LOADS

94. Midwest's Large Volume Interruptible tariff includes a special provision which would allow air conditioning, cogeneration, natural gas vehicles, and similar loads to receive service under the Large Volume Interruptible tariff, even if the loads do not meet the necessary size requirements to receive service under this tariff. Midwest states that the provision is intended as an incentive to attract off-peak loads and loads with potentially high load factors to Midwest's system.

95. The DPS objected to this provision because it believed customers should receive service based on their load characteristics, not their types of end-uses. The Administrative Law Judge finds that the special provision will deviate from past rate design classifications by basing a customer's eligibility for the lower Large Volume rate upon the customer's end-use. Basing a classification on a customer's end-use rather than load

characteristics could result in unfair and discriminatory rate treatment. Customers should receive service under a particular tariff based on their load characteristics, not their end-use. Therefore, the new tariff provision is inappropriate and should not be implemented.

#### SPECIAL CONTRACT PROVISION FOR SVI AND LVI

96. Midwest has a Special Contracts Provision as part of its LVI and SVI tariffs. According to Midwest, these provisions offer reduced rates to customers who might otherwise bypass Midwest's system.

97. The Special Contract provision is a flexible rate. Minn. Stat. 216B.163 requires that a flexible rate apply only to a customer that is subject to "effective competition." Therefore, the Commission may make flexible rates available only when "effective competition" exists. Whether "effective competition" exists for SVI and LVI customers has not been an issue in this proceeding. The Legislature has determined that "effective competition" exists for larger volume interruptible customers with usage exceeding 199,000 cubic feet per day. Minn. Stat. 216B.163, subd. 2 (1990). For uses less than that amount, there must be a determination of whether "effective competition" exists.

98. On the basis of the foregoing, the Administrative Law Judge believes that it would be inappropriate and inconsistent with 216B.163 to approve the Special Contract provision for SVI and LVI customers using less than 199,000 cubic feet per day.

#### REVENUE RESPONSIBILITY FOR FLEXIBLE CUSTOMERS

100. Minn. Stat. 216B.163 (1990) authorizes gas utilities to offer flexible rates. The statute allows utilities to flex rates downward to meet competitive circumstances, or to flex upward if the cost of gas is less than the cost of alternative fuels. The Commission has set minimum and maximum rates that could be paid by Midwest flexible customers in Docket No. G-010/M-90-407, December 3, 1990. The Commission "standard rate", which is the midpoint between the ceiling rate and the rate floor, is the rate charged on the equivalent non-flexible tariff.

101. The Department and the Attorney General both recommend the use of the standard rate for the purpose of determining the revenues generated by the flexible rate classes. These parties reason that because the rates may be flexed both downward and upward, revenues should be calculated based on the midpoint, which is the standard rate.

102. Midwest believes that revenues from flexible rates will never be at the level imagined by the DPS and the OAG. The Company proposes that the revenues for the flexible tariffs be set at the historical level of revenues realized by the Company.

103. The Company has failed to meet its burden of proof on this issue. There is no evidence of the Company's actual level of revenues under flexible tariffs for the previous years. The Company has presented no historical data showing that Midwest has had to price flexible rates below the standard rate. Lacking supporting data, Midwest has failed to prove its claim that the



standard rate is too high, and has failed to demonstrate the reasonableness of its proposed measure. Setting the measure of flexible revenues at the standard rate is reasonable because it provides Midwest an incentive to flex the rate as high as possible and still retain the customer on the system.

104. Midwest's flexible gas rates should be calculated at the standard rate .

105. In a Memorandum to the parties dated March 22, 1991 from the Commission's Executive Secretary, the parties were notified of certain revenue calculations undertaken by Commission Staff relating to Midwest's flex rate customers. Commission staff performed certain calculations to ascertain the level of revenue collections that Midwest would receive if flexed rates were computed using the standard rate. The computation using the standard rate will be presented to the Commission as an additional alternative for consideration. Because all parties who desire to comment have had an opportunity to do so, the Administrative law judge finds that this proposed action has been properly and officially noticed.

106. Computation of Midwest's flexible gas rates at the standard rate will result in an increase of revenues totaling \$55,256.

#### CONCEPTS TO GOVERN

107. It is the intent of the Administrative Law Judge that the concepts set forth in the Findings herein should govern the mathematical and computational aspects of the Findings and Conclusions. Any mathematical or computational errors are unintentional and should be corrected to conform to the concepts expressed in the Findings and Conclusions.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

#### CONCLUSIONS

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject of the hearing pursuant to Minn. Stat. Ch. 216B and 14.57 - 14.62 (1990), and Minn. Rules Pts. 1400.5100 - 1400.8300.

2. The Commission gave proper notice of hearing in this matter, has fulfilled all relevant substantive and procedural requirements of law or rule and has the authority to take the proposed action.

3. The proposed test year for determining Midwest's revenue deficiency, if any, is the 12-month period between January 1, 1990 and December 31, 1990, is appropriate.

4. Midwest's acquisition adjustment arising from acquiring North Central Public Service Company should be included in rate base.

5. The jurisdictional rate base of the Company for use in this proceeding is \$42,794,577.

6. The operating revenues of the Company for the test year under

present rates are \$46,189,952. It is appropriate to also include in test year operating revenues the additional revenues that arise from the computation of Midwest's flexible gas rates at the standard rate.

7. Test year expenses should be reduced by \$45,000 arising from the marketing of the Conversion Rebate Program. Test year expenses should be reduced by \$90,183 to reflect sales expenses withdrawn or not justified by Midwest.

8. A conservation cost recovery charge should be built into rates to allow for the collection of \$148,560 in expenses associated with Midwest's conservation improvement plan.

9. Test year expenses should be reduced by \$2,000 to disallow the expenses of the Energy Conservation Library.

10. Midwest has withdrawn lobbying expenses of \$14,000 and Chamber of Commerce dues of \$1,530 from its request for rate recovery. Withdrawal of these expenses should be reflected in the test year operating income.

11. The net operating income of the Company for the test year is \$3,155,014 excluding the effect of flex rate computations using the standard rate, lobbying expenses and Chamber of Commerce dues.

12. The overall rate of return for Midwest in this proceeding is 10.144% based upon the following capitalization ratios and rates: 43.74% of common equity at a cost rate of 12.50%; 46.51% of long-term debt at a cost rate of 8.592%; 9.75% of preferred stock at a cost rate of 6.984%.

13. The revenue deficiency for the Company during the test year period is \$1,992,386.

14. Customers on the Viking Gas and customers on the Northern Natural Gas systems should not be consolidated into one class.

15. The apportionment of the increase in revenues required by this proceeding should be based on a 1% increase of the average bills of all customer classes.

16. Reconnection charges should be set at \$21 during normal business hours and \$23 for after-hours connections.

17. The Company shall create a new Medium Firm class for customers having peak-day requirements of 500 therms or more. The Company will study the usage patterns of the class and report in the next general rate case filing of the Company.

18. It would be inappropriate to approve the special contract provision for SVI or LVI without a determination and finding of effective competition as required by Minn. Stat. 216B.163, subd. 2 (1990).

18. Any Finding of Fact more properly considered a Conclusion, or any Conclusion more properly considered a Finding of Fact, is hereby expressly adopted as such.

THIS REPORT IS NOT AN ORDER AND NO AUTHORITY IS GRANTED HEREIN. THE PUBLIC UTILITIES COMMISSION WILL ISSUE THE ORDER OF AUTHORITY WHICH MAY ADOPT OR DIFFER FROM THE FOLLOWING RECOMMENDATIONS.



It is the recommendation of the Administrative Law Judge to the Public Utilities Commission that it issue the following:

ORDER

- (1) Within thirty (30) days of the date of this Order, Midwest Gas shall file with the Commission for its approval and provide to all parties to this proceeding, a revised schedule of rates and charges, incorporating the decisions made herein, so as to allow the production of increased annual revenues of \$1,992,386 for its retail gas operations within the State of Minnesota during the test year, January 1, 1990 through December 31, 1990, in accordance with the determinations made herein.
- (2) Within thirty (30) days of the date of this Order, the Company shall file with the Commission for its review and approval, and serve upon all parties of this proceeding, a proposal to refund to its customers any monies collected in excess of the increase authorized herein.
- (3) This Order shall become effective immediately.

Dated this 10th day of May, 1991.

ALLEN E. GILES  
Administrative Law Judge

NOTICE

Pursuant to Minn. Stat. 14.62, subd. 1, the agency is required to serve its final decision upon each party and the Administrative Law Judge by first class mail.

Reported: Court Reported. Karen Toughill  
Allen J. Thiry  
Summit Court Reporters.

